

**REBUTTAL COMMENTS TO THE
PRESIDENT'S COMMISSION
ON THE UNITED STATES POSTAL SERVICE
BY
AMERICAN BUSINESS MEDIA**

Although American Business Media is availing itself of this opportunity to submit rebuttal comments for the Commission's consideration, our doing so should not be interpreted as reflecting wide-ranging disagreement with our colleagues in the publishing industry or with the broader cross section of mailers and organizations filing initial comments. In fact, American Business Media's initial comments were to a great extent consistent with those offered by the Magazine Publishers of America, AOL Time Warner, Readers Digest, Advance Magazine Group and others on a number of important issues. That congruity of views should not be surprising, given our shared interest in a healthy, efficient postal system that continues to recognize the special place of periodicals in the mail stream and in the mail box.

Nevertheless, as we predicated in our initial comments:

American Business Media's positions in support of the present [ratemaking] system and in favor of a stronger Postal rate Commission are likely to be markedly different from those of most of the major mail organizations that represent primarily the highest volume mailers.

In fact, the effectiveness of the present ratemaking system does represent the most substantial disagreement between American Business Media and most of the other publishing interests and others that have commented on this issue. These rebuttal comments will therefore focus on ratemaking.

American Business Media recognized in its initial comments that the present ratemaking system is cumbersome and time consuming, although, as we also explained, such characteristics are typical for major regulatory proceedings of this type. Moreover, despite its shortcomings, the present system has performed well over the years. Mailers' primary problem with postal rates has been the speed at which they have increased to reflect escalating postal costs, not the speed with which the Postal Rate Commission issues decisions.

Those suggesting that the system be scrapped should have borne, but did not, the burden of proposing an alternative that continues to provide an appropriate level of protection to captive mailers and imposes a suitable level of regulation on the Postal Service, at least with respect to those services where it has either a *de facto* or a *de jure* monopoly.

They have not done so, nor do their comments do more than suggest a general approach. It is easy to assert that rates should be constrained by inflation, or that Postal Service flexibility should be kept in check with a complaint-based system. But to offer such suggestions without providing the details of what should be done when cost increases (despite the best efforts of management) exceed the inflation rate or how mailers are to obtain the data necessary to support a rate complaint, and how they should be protected as a compliant proceeding is heard, does not demonstrate that there is a better ratemaking system to be had. Criticism and concepts are easy; as

Congress found out, development of a new and better, comprehensive system for setting postal rates may well be impossible.

Turning to the specific statements addressed here, we first note that, given their sheer number, we are not able to identify each of the parties adopting any particular position, nor can this rebuttal statement address every rate-related comment by others with which American Business Media takes issue. We do believe that the specific statements addressed below, if not complete, are representative of particular viewpoints with which American Business Media disagrees and will address in this rebuttal statement.

The calls for change in the current pricing system begin, typically, with criticisms of that system. Two parties—R.R. Donnelley and Advo—go so far as to suggest that cost-based ratemaking is an anachronism that must be discarded. Donnelley argues (at 12) that the existing system “entails classic cost-of-service ratemaking that has been discarded in all other industries, including telecommunications, electricity and gas industries.” Advo parrots that remark, arguing that “[t]he Postal Service is the very last public utility that is subject to strict cost of service regulation.”

These threshold attacks on postal ratemaking are preposterous. They are also and demonstrably wrong as a factual matter. In the electric industry, for example, although some states have experimented with a substitution of market-based rates for cost-based rates, the majority still impose cost-based regulation on providers of this

essential service.¹ In addition, even though there has been more of a movement away from cost-based rates at the wholesale power sales level (where there is greater competition), the Federal Energy Regulatory Commission has maintained strict cost-based regulation of the most important electric service within its jurisdiction—transmission of power in interstate commerce (where there remains a *de facto* monopoly).

What's more, the electric industry stands as a prime example of what can go wrong when cost-based ratemaking is abandoned based upon an assumption that a robust market will provide the necessary customer protection. The page limitation here does not permit a full-blown analysis of today's electricity markets. Instead, we will rely on a single document, the most recent issue of the "Foster Electric Report," a weekly newsletter, for examples proving that cost-based ratemaking has not been abandoned and that, in fact, there is movement away from market-based pricing and the economic dislocation that it can cause.

In its March 5 edition, this report: (1) detailed claims by the state of California seeking \$16.5 *billion* in refunds of overcharges during 2000-01 by electric utilities that manipulated the supposedly competitive market that had replaced cost-based

¹ According to official government statistics, issued by the Department of Energy's Energy Information Administration, twenty-four of the fifty states embarked on the process of replacing cost regulation with competition in the retail electricity market, but of those twenty-four, one (California) has suspended its program, and five others (Oklahoma, Montana, Arkansas, New Mexico and Nevada) have delayed them, leaving only eighteen with active programs moving away from cost-based rate regulation. This information can be found at: <http://www.eia.doe.gov/cneaf/electricity/chg_str/regmap.html>

regulation in California, (2) described a FERC order delving into minute cost detail concerning strictly cost-based transmission rates to be charged by the Midwest Independent System Operator (a transmission provider), (3) and reported that the state of Arkansas has repealed its four-year old law that replaced cost-based ratemaking for retail electricity with competition, primarily on the basis of a study that showed that allowing rates to be set by “the market” would cause rates to increase by 13% over what they will be under cost-of-service regulation. As American Business Media said in its initial statement, cost-of-service ratemaking is alive and well. What appear to be falling flat are attempts to substitute market-based prices for cost-based prices when essential services and monopoly power are involved.²

Other criticisms of the present process are more focused on that process itself, rather than on the threshold issue of cost-based ratemaking. For example, Donnelley contends (at 7) that with tens of thousands of pages of evidence in the record of a rate case and hundreds of pages in the typical Rate Commission decision, “this approach is clearly not capable of producing meaningful results, leaving many key issues overlooked. . . .” This *non sequitur* shows how much the Commission is able to

² Suggestions that robust competition in the parcel and express delivery areas call into question the Postal Service’s monopoly power in other areas fail to address the difference between markets in which the average revenue per piece is measured in dollars and markets in which such revenues are measured in cents. The failure of Publishers Express and others to succeed in shifting periodicals to alternate delivery exemplifies that difference. In the same vein, the suggestion by the Mail Order Association of America (at 5) that the “principle reason for imposing regulation upon the Postal Service has been the legal monopoly over many types of mail” is wrong to the extent that it downplays the need for protection for customers purchasing *de facto* monopoly services.

accomplish. Would Donnelley be more confident of the outcome if the evidentiary record were hundreds of pages long and led to a fifty-page decision?

Although the proponents of massive change fail to propose a comprehensive alternative to the present system, they do suggest certain features that any alternative should include. Perhaps the most commonly mentioned is a rate cap tied to the rate of inflation, a concept included in each of the failed postal reform bills. For example, AOL Time Warner (at 14) suggests that there be an “inflation-based rate cap,” as does Magazine Publishers of America (at 11-12), with total Postal Service flexibility below that cap. They offer no concrete proposal for how cost increases that exceed the rate of inflation should be dealt with.³

Similarly, Readers Digest (at 6) and Donnelley (at 8) suggest an inflation-based cap, although each goes one step further by seeking a reduction in the permitted rate cap to reflect anticipated or mandated productivity gains. Donnelley adds that increases above the cap should be subject to Postal Rate Commission procedures, although it does not indicate the nature of such procedures.

All of these proposals suffer from the same shortcomings as did their legislative predecessors, including the fact that price caps do not work in a situation where there are no residual stakeholders, such as stockholders, to impose discipline on the service provider. None of the economists called to testify before Congressman McHugh’s

³ Because it is labor and fuel intensive, the Postal Service is exposed to unavoidable cost increases that exceed any broad measure on inflation.

subcommittee would endorse a price cap approach. In addition, as explained in American Business Media's initial statement, a rate cap imposed at the subclass level, such as "Regular Rate Periodicals," offers little protection to individual mailers or types of mailers within that subclass, such as smaller circulation or high editorial content publications.

AOL Time Warner (at 17), Advo (at 4) and Magazine Publishers of America (at 12) do suggest that some sort of complaint mechanism might offer adequate protection to mailers under this largely deregulated approach, but none of them offers a proposal with any detail. For example, would a complaint be possible only if a rate were increased for an entire subclass by more than the cap, or would mailers such as American Business Media members be permitted to lodge a complaint if their rates were to increase by 20% while others in the same subclass were to enjoy offsetting rate reductions?

Also lacking from any of these sketchy proposals is a description of the procedures that would be followed after the submission of a complaint. Although AOL Time Warner mentions that an administrative law judge would be involved, and Magazine Publishers of America would require that complaints be dealt with "promptly," neither provides any substance, and as Congress learned, the devil truly is on the detail.

Our concern here is very important, since any system of rate regulation that shifts the practical and the legal burden of proof to the customer when rates are

increased would be a first in the world of rate regulation. In the more limited world of postal rate regulation, such a burden would render any such relief illusory.

If today's rate cases are deemed to be too great a burden for the postal customers to bear, imagine the burden on a single user, or a group of similarly situated users, faced with a rate increase that they believe might be prohibited by the price cap or by applicable standards (although the proponents of change have not stated whether there would be any such standards). There would be no rate filing replete with data from which that customer, or more likely its hired consultants, could formulate an initial conclusion on the extent to which a rate might be unlawful. Assuming that all of the necessary data could be forced out of the Postal Service, the cost and delay inherent in that process would almost certainly be too much for any party to bear. But if that party nonetheless proceeded, it would then, we assume, be faced with a hearing and an array of opposition, including the Postal Service and those parties that favored the rates.

During the many months that this complaint process would take, the customer would most likely be paying the new rates, and would most likely not be entitled to a refund in the event that its complaint were successful. We say "most likely" both because the proponents of this plan have not provided any detail and because such an approach is consistent with existing law. If these assumptions are correct, the suggestion of the right to file a complaint is virtually worthless, both because of the enormous costs that would be involved and because any relief obtained could be eliminated by the Postal Service with new rates enacted by the stroke of a pen.

Two parties, Advo and the Direct Marketing Association, offer suggestions beyond the mere mention of a price cap. Advo (at 5) disfavors price caps or any formulaic approach and recommends instead an ill-defined system whereby a regulatory body develops a “zone of reasonableness” within which all rates must fall. Advo does not explain whether the development of such a zone would rely upon a hearing process or what would happen if the Postal Service determined that just and reasonable rates for one or more classes would fall outside of that zone.

DMA’s proposal (at 7) is more elaborate. It would divide rates by function, so that there would be separate rates and a separate rate mechanism for delivery than for “up stream” functions. As we understand this proposal, there would be no regulation of delivery function rates if they did not increase by more than the rate of inflation. DMA does not say what form the regulation would take if an increase larger than the rate of inflation were necessary. The remainder of the rates, those that apply to the processing, transportation and other functions, would be totally unregulated because the “competitive process” will result in “market prices.” This leap of faith is at least as great as that which led to the billions of dollars of electricity overcharges in California. And even if the overall level of revenues is constrained by market forces, there is no protection in this proposal for those customers whose size precludes their ability to take advantage of whatever competitive alternatives exist.

In sum, those proposing to replace the existing ratemaking provisions in the Postal Reorganization Act do little more than toss concepts on the table. Some of those

concepts, such as limiting rate increases to the rate of inflation, ought to be attractive to all mail users (although Periodical mailers especially would hope to see the recent cost increases at a much higher rate replaced by some actual cost decreases as automation savings are realized). Translating these concepts into a comprehensive system that provides adequate revenues to the Postal Service, does not create incentives for reducing service when the Postal Service is faced with increasing costs, protects ratepayers—not just amorphous subclasses—against excessive rate increases and recognizes the legitimate policies of the Postal Reorganization Act is a far more difficult task. Congress was unable to accomplish that task, and none of the statements filed with the Commission provides a great deal of insight.

American Business Media is not saying that the present system is perfect. What we are saying, as we did in our initial comments, is that it works reasonably well and that excessive focus on replacing it could well detract from the far more important issues facing this Commission—issues related to Postal Service control over costs addressed in American Business Media's initial statement and in the statements of other parties.

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